insightpaper

NEW ZEALAND BUDGET 2015

MAY 2015

Highlights

- The 2015 Budget sees a continuation of fiscal restraint with new initiatives being funded out of the new allocation allowance along with some re-prioritisation of other spending.
- Revenue forecasts have been lowered again as a result of lower nominal GDP growth but it is still forecast to rise as a proportion of GDP over the projection period.
- As has been well flagged, the achievement of an operating surplus has been delayed to 2015/16. However, the trend improvement in the operating balance remains in place which is important for markets and rating agencies.
- Economic assumptions underpinning the Budget are broadly in line with our own and therefore appear reasonable. Key judgements about the risks to the outlook also seem reasonable.
- Key policy initiatives include a package of measures to support children in hardship – in return for greater work obligations as well as the earlier announced reduction in ACC levies and measures to tighten the tax treatment of housing.
- As expected, the bond programme remains largely unchanged and the fiscal impulse remains negative on average over the projection period. This Budget should hold no surprises for financial markets.

BEVAN GRAHAM
AMP Chief Economist

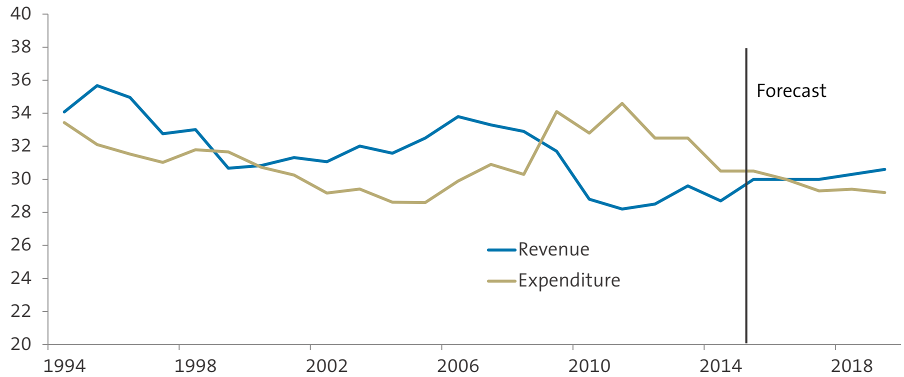
UNDERLYING ECONOMIC ASSUMPTIONS

The Treasury's economic assumptions are reasonable and broadly consistent with our own. In terms of the growth profile, the Treasury is forecasting solid growth in the period ahead on the back of low interest rates, robust investment activity, strong population growth and the high terms of trade. Sluggish global growth, drought and tight Government spending provide offsets. The only difference is we have the cycle tailing off a bit faster in the out-years.

The Treasury acknowledges the uncertainties over the forecast period, including the prospects for trading partner growth, oil and dairy prices, and the extent and duration of the current net migration boom. All forecasters are grappling with the same uncertainties but the judgements the Treasury makes on each of these appear reasonable. They expect global growth to continue to gradually improve, oil and dairy prices to gradually rise and for net migration to return to its long-run average during fiscal year 2017.

The Treasury acknowledges subdued wage pressures and current low inflation but, like us, expects inflation to head back to 2% in late 2016 as capacity pressures develop. Low inflation means interest rates remain lower for longer and a further downward revision to growth in nominal GDP. Compared to the Half Year Economic and Fiscal Update (HYEFU), nominal GDP growth is weaker in 2016 and 2017, but stronger in 2018 and 2019.

Core Crown Revenue and Expenditure
% of GDP



Source: NZ Treasury

BY THE NUMBERS

As was flagged in the HYEFU, achievement of a fiscal surplus has been delayed from 2014/15 to 2015/16. This was largely a reflection of weaker nominal GDP and resultant lower tax revenues (GST). Treasury is forecasting a deficit of $0.7 billion (-0.3% of GDP) in the current fiscal year, a small surplus of $0.2 billion (0.1%) in 2015/16, rising to $3.6 billion (1.3%) in 2018/19.

The modest size of future surpluses (especially next year) makes them vulnerable to adverse economic surprises. Indeed, in one of two alternative scenarios presented by the Treasury incorporating lower commodity prices sees the achievement of surplus pushed out to 2018/19. But, surprises could be positive too. A second scenario shows the impact of stronger household demand and migration with slightly larger surpluses over the forecast period. However, the downside scenario has the more meaningful impact.

The delay in reaching surplus is of limited economic consequence as the improving trend in the Crown's accounts remains in place. This is also what rating agencies will focus on.

Apart from the current year, Treasury has again revised down tax revenue forecasts from those presented in the HYEFU given further downward revisions to nominal GDP (inflation), wages and interest rates. However, core Crown revenue increases from 28.7% of GDP in 2013/14 to 30.6% in 2018/19.

Core crown expenses continue to trend lower, falling from 30.5% of GDP in 2013/14 to 29.2% in 2018/19. Future operating allowances are unchanged from the HYEFU at $1.0 billion for Budget 2016, $2.5 billion in 2017 (election year) and then $1.5 billion in 2018.

Net core Crown debt is expected to peak at 26.3% of GDP in 2015/16 before reducing to 22.9% of GDP in 2018/19. This trajectory will continue to make New Zealand's fiscal position the envy of the developed world.

Economic Assumptions
March Years

	2015	2016	2017	2018
Economic Growth				
Treasury	3.3	3.1	2.8	2.8
AMP Capital	3.3	3.3	2.9	2.3
Unemployment Rate				
Treasury	5.6	5.1	4.7	4.5
AMP Capital	5.8	5.3	4.6	4.3
CPI Inflation				
Treasury	0.2	1.4	2.1	2.0
AMP Capital	0.1	1.3	1.9	2.1
Current Account				
Treasury	-4.1	-5.6	-4.9	-5.1
AMP Capital	-4.1	-5.5	-5.1	-5.3

Source: NZ Treasury and AMP Capital

Economic growth is annual average percent change
Unemployment rate is as at March
CPI Inflation is annual percent change at March
Current account balance is % of GDP

KEY POLICY INITIATIVES

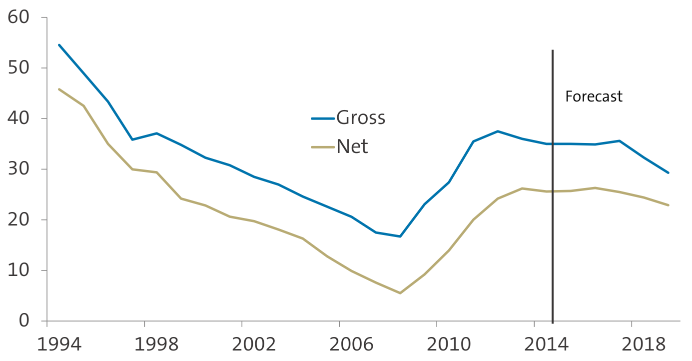
The flagship initiative is a $790 million package over four years to help children living in New Zealand's poorest families. This includes increases in benefit rates and support from Working for Families, as well as more childcare support for low income families.

This Government has put a lot of emphasis on reducing long term dependency and achieving better outcomes for families most in need. It should come as no surprise that this increased support for vulnerable families comes with reciprocal obligations to move into part-time work earlier (when the youngest child reaches age three rather than five) and to work longer hours (20 hours a week, up from 15).

As we've come to expect, health was the major winner on the day with an extra $1.7 billion over four years. Education also receives an extra $443 million over four years in operational funding.

Major initiatives announced pre-Budget include a further reduction in ACC levies ($120 million) following on from last year's announcement ($375 million). Further levy reductions have been flagged in the out-years.

Crown debt
% of GDP



Source: NZ Treasury

Housing has been a key focus recently. The Government is setting aside a capital contingency of $52 million for housing development on underutilized Crown land in Auckland. Fixing supply remains the only real long term solution to Auckland's supply demand imbalance. This follows the earlier announcement to strengthen the tax rules, and their enforcement, on property transactions.

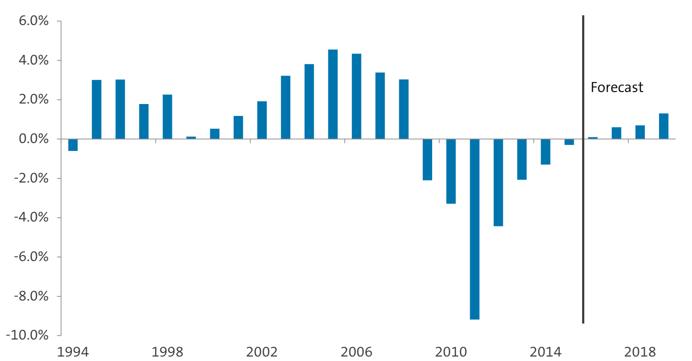
Under the Business Growth Agenda banner, there is further investment in tertiary education, research and innovation. This includes establishing new Regional Research Institutes and an increase in R&D growth grants.

New infrastructure spending of $939 million, including on KiwiRail and the rollout of ultra-fast broadband, will be funded from the Future Investment Fund, the fund set up from the proceeds of the earlier programme of partial asset sales.

One surprise in the Budget today is the removal of the $1000 'kick start' for new members into Kiwisaver. This is to be effective immediately. The annual tax credit remains unchanged.

One of the challenges for the Government is to improve the sustainability of fiscal policy into the future. It has always seemed to us that an important part of achieving that sustainability is to shift responsibility for the provision of retirement income from the State to private individuals. If the Government wants to reduce the cost of retirement income policy, we'd prefer they targeted the unsustainably high costs of New Zealand Superannuation. On the upside, removing the kick-start payment probably makes auto-enrolment more likely at some point in the future.

Fiscal Balance
Operating Balance Excluding Gains and Losses



Source: NZ Treasury

Key Fiscal Ratios
June Years, %of GDP

	2014	2015(e)	2016(f)	2017(f)	2018(f)	2019(f)
Core Crown Expenditure	30.5	30.5	30.0	29.3	29.4	29.2
Core Crown Revenue	28.7	30.0	30.0	30.0	30.3	30.6
Operating Balance (OBEGAL)	-1.3	-0.3	0.1	0.6	0.7	1.3
Net Debt	25.6	25.7	26.3	25.5	24.4	22.9
Gross Debt	35.0	34.9	35.6	32.3	29.3	
Net Worth	34.5	33.4	33.2	33.2	33.5	34.6

CONCLUSIONS AND MARKET IMPLICATIONS

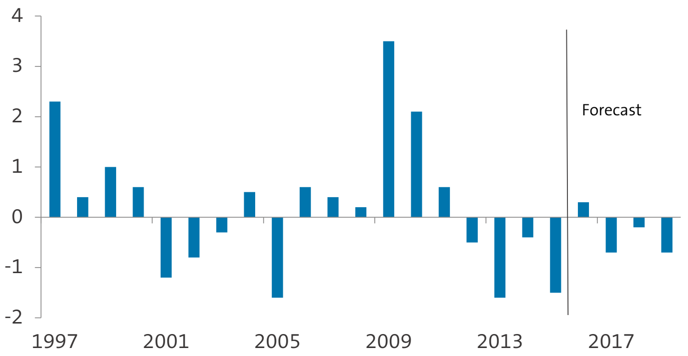
In general, this was another “no surprises” Budget. New spending was within the new allocation cap and was bolstered by savings in other areas. However, the nature of the new spending (benefits and Working for Families) contrasted with where the savings came from (KiwiSaver) makes this Budget more stimulatory then we were expecting.

Despite missing the surplus target, which is more a political embarrassment than anything more meaningful, the trend improvement in the Crown’s accounts is forecast to continue and those forecasts are based on reasonable assumptions.

There doesn’t appear to be anything in this Budget to cause markets any concern. The 2015/16 bond programme has been increased from $7.0 billion to $8.0 billion given lower revenues, but the programme beyond 2015/16 remains unchanged.

After being sharply negative in 2014/15 the fiscal impulse moves briefly positive in 2015/16 due to timing of cash flow receipts and some expenditure items. But the picture of fiscal policy being contractionary on average over the forecast period remains unchanged. We don’t expect this Budget changes anything for the Reserve Bank of New Zealand and the outlook for monetary policy.

Fiscal Impulse
Percent of GDP



Source: NZ Treasury

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